



STATE OF WASHINGTON

ECONOMIC AND REVENUE FORECAST COUNCIL

Capitol Plaza Building, PO Box 40912 • Olympia, Washington 98504-0912 • (360) 570-6100

November 1, 2004

TO: Governor's Council of Economic Advisors

FROM: Chang Mook Sohn, Executive Director
Economic and Revenue Forecast Council

SUBJECT: PRELIMINARY OCTOBER ECONOMIC FORECAST

This preliminary forecast was based on Global Insight's October Control forecast for the U.S. economy. You should have received a summary of the Global Insight forecast by email. If not, please contact our office. The forecast was produced prior to the advance GDP estimate for the third quarter of 2004. According to the forecast, real GDP grew at a 4.2 percent rate in the third quarter of 2004 up from 3.3 percent in the first quarter (the advance estimate came in a bit weaker at 3.7 percent). The improvement was primarily due to consumer spending which recovered to 4.7 percent in the third quarter from 1.6 percent in the second quarter as auto sales rebounded. According to the forecast, payroll employment growth slowed to 1.1 percent in the third quarter from 2.3 percent in the second quarter but the unemployment rate declined to 5.43 percent from 5.60 percent. As in September, the forecast incorporates the one-time dividend Microsoft will pay in December 2004, which will cause a significant jump in personal income in the fourth quarter. The economic impact of the dividend is expected to be minimal, however, since most of it will be reinvested. The forecast assumes a 25-basis-point increase in the federal funds rate in November, but no move in December. Overall, the new national forecast is somewhat weaker than the forecast adopted in September in most respects including GDP, employment, and income growth.

A comparison of the preliminary U.S. forecast with the forecast adopted in September is shown in Table 2.

The Washington State forecast reflects the slightly weaker growth in the new U.S. forecast. The Washington aerospace employment forecast is virtually identical to the September forecast. As in September, it reflects the Boeing announcement that it will hire up to 3,000 by the end of the year. As a result of recent experience and data revisions, the forecast for December is about 300 higher than assumed in September. The pattern of growth after December is essentially unchanged but the higher starting level carries forward. The forecast expects an increase of 11,900 in 2005, 2006, and 2007. The software wage assumptions are also virtually identical to the September assumptions.

Microsoft stock options are expected to continue to decline but income from stock grants will grow. Software employment is expected to end the year about 900 higher than assumed in September. Software employment is expected to increase 6,400 during the next three years. The forecast also reflects the AT&T Wireless-Cingular merger. There will likely be employment reductions though the magnitude and timing of any cuts are unknown. The forecast assumes a total reduction of 2,500 during the first three quarters of 2005.

This forecast also incorporates newly available Covered Employment and Payrolls (ES-202) data for the second quarter of 2004. The benchmark revision to the second quarter subtracted 2,400 from the level of employment in June. In addition, employment growth from June through September was 5,300 less than expected. The combined effect was a 7,700 reduction in the estimate for September. The ES-202 data also indicate that second quarter wages were \$0.281 billion higher than expected in September. Software wages were on target, just \$0.025 billion lower than expected. Non-software wages, however, were \$0.306 billion higher. Nonwage personal income was \$0.844 billion lower than expected in September. The revision to total personal income in the second quarter was a negative \$0.563 billion. The forecast also reflects Seattle consumer price data through August, which continues to show local inflation running well below the national average. Seattle's over-the-year core inflation was a negative 0.6 percent compared to a positive 1.7 percent for the U.S. city average. The number of housing units authorized by building permit jumped to 50,700 in the third quarter from 46,500 in the second quarter. Housing has not been this strong in Washington since 1990.

A comparison of the preliminary Washington forecast with the forecast adopted in September is shown in Table 3.

Review of the forecast by the Governor's Council of Economic Advisors is scheduled for Friday November 5, 2004 at 10:00 a.m., in the **Insurance Building 4th floor conference room**.

If you have any questions, please contact Bret Bertolin, Senior Economic Forecaster, at (360) 570-6106.

PLEASE NOTE:

Enclosed is a worksheet summarizing the preliminary forecast. **Council members are strongly encouraged to complete and return this worksheet either in person at the Governor's Council meeting or, if unable to attend, by FAX to (360) 753-7022.** This worksheet is relied on by the Forecast Council members and staff to gauge the reasonableness of the preliminary economic forecast and also serves as the basis of an alternative economic and revenue forecast.

Fluctuations in software wages due to stock option income have, in the past, caused significant distortions in overall wage and personal income trends. The vesting of the first round of Microsoft stock awards as well as bonus payments temporarily boosted wages in the third quarter. Since these will not be repeated in the fourth quarter, the result is a negative impact on wage and income growth.

	2004:4	2005	2006	2007:1,2
<u>Washington Real Personal Income, %Ch.</u>				
Baseline	6.7	3.6	4.1	3.9
Excluding Software	8.2	3.5	3.9	4.0
Software's Impact	-1.4	0.1	0.1	-0.1
<u>Washington Average Annual Wage, %Ch.</u>				
Baseline	1.6	3.8	4.3	4.5
Excluding Software	4.1	3.7	4.1	4.8
Software's Impact	-2.5	0.1	0.2	-0.3

CMS: dym/bb
Enclosures

Table 1
U.S. Economic Forecast Comparison
October 2004

	2004Q3	2004Q4	2005Q1	2005Q2	2004	2005	2006	2007
Real GDP, Percent Change								
Global Insight	4.2	3.4	3.5	3.5	4.4	3.4	2.9	3.2
Blue Chip	3.8	3.7	3.5	3.5	4.4	3.5		
Economy.com	4.2	3.6	3.2	2.7	4.4	3.3		
S&P	4.5	3.8	3.3		4.5	3.5	3.2	3.6
Merril Lynch	4.0	2.3	2.5	3.0	4.3	3.0		
Federal Funds Rate								
Global Insight	1.44	1.87	2.18	2.50	1.33	2.62	3.39	3.53
Blue Chip*	1.7	2.1	2.5	2.8	1.5	2.9		
Economy.com	1.43	1.96	2.50		1.35	3.04		
S&P	1.4	1.9	2.2		1.3	2.9	3.5	3.8
Consumer Price Index, Percent Change								
Global Insight	1.8	2.0	1.7	1.5	2.6	1.8	1.4	1.7
Blue Chip	2.2	2.3	2.3	2.2	2.6	2.4		
Economy.com	2.3	1.9	1.7		2.6	2.0		
S&P	1.8	2.0	1.7		2.6	1.9	1.6	2.0
Merril Lynch	1.8	1.5	1.6	1.8	2.6	1.8		
Payroll Employment, Millions								
Global Insight	131.5	132.0	132.7	133.3	131.2	133.5	135.0	136.2
Economy.com	131.6	132.3	132.9		131.3	133.8		
S&P	131.5	132.1	132.8		131.3	133.7	135.3	137.0
Unemployment Rate, Percent								
Global Insight	5.43	5.37	5.31	5.29	5.51	5.33	5.53	5.61
Blue Chip	5.5	5.4	5.3	5.3	5.5	5.3		
Economy.com	5.5	5.5	5.5		5.6	5.4		
S&P	5.4	5.3	5.2		5.5	5.3	5.4	5.2
Merril Lynch	5.4	5.6	5.7	5.6	5.6	5.6		
Real Disposable Personal Income, Percent Change								
Global Insight	2.2	7.8	-0.8	3.2	3.3	2.7	3.0	3.0
Blue Chip	2.4	3.8	3.2	3.5	3.2	3.3		
Merril Lynch	1.4	1.9	1.6	2.4	2.9	2.0		

* Estimate based on T-bill rate.

Table 2

U.S. Forecast Comparison

	2004Q1	2004Q2	2004Q3	2004Q4	2005Q1	2005Q2	2003	2004	2005	2006	2007
Real GDP (Billions of Chained 2000 Dollars)											
October	10697.5	10784.7	10895.2	10985.7	11081.6	11176.9	10381.3	10840.8	11211.4	11541.1	11910.2
Percent Change	4.5	3.3	4.2	3.4	3.5	3.5	3.0	4.4	3.4	2.9	3.2
August	10697.5	10778.0	10868.5	10987.4	11088.1	11189.7	10381.3	10832.9	11220.9	11567.6	11955.9
Percent Change	4.5	3.0	3.4	4.4	3.7	3.7	3.0	4.3	3.6	3.1	3.4
Implicit Price Deflator (2000=1.000)											
October	1.069	1.077	1.080	1.085	1.089	1.094	1.055	1.078	1.096	1.114	1.135
Percent Change	3.3	3.1	1.2	1.8	1.7	1.6	1.9	2.1	1.7	1.7	1.9
August	1.069	1.077	1.083	1.088	1.092	1.095	1.055	1.079	1.098	1.116	1.139
Percent Change	3.3	3.3	2.2	1.8	1.4	1.4	1.9	2.3	1.7	1.7	2.1
Real Personal Income (Billions of Chained 2000 Dollars)											
October	8838.7	8899.6	8951.2	9117.3	9119.0	9200.1	8683.0	8951.7	9235.9	9548.1	9861.0
Percent Change	1.7	2.8	2.3	7.6	0.1	3.6	1.3	3.1	3.2	3.4	3.3
August	8857.8	8925.4	9002.7	9169.9	9172.4	9259.1	8683.0	8989.0	9295.7	9637.0	9987.4
Percent Change	2.6	3.1	3.5	7.6	0.1	3.8	1.3	3.5	3.4	3.7	3.6
Wage and Salary Employment											
October	130.37	131.12	131.48	131.99	132.66	133.33	129.94	131.24	133.50	134.96	136.16
Percent Change	1.1	2.3	1.1	1.6	2.1	2.0	-0.3	1.0	1.7	1.1	0.9
August	130.37	131.12	131.42	132.00	132.53	133.17	129.94	131.23	133.39	135.29	136.95
Percent Change	1.1	2.3	0.9	1.8	1.6	2.0	-0.3	1.0	1.7	1.4	1.2
Unemployment Rate											
October	5.63	5.60	5.43	5.37	5.31	5.29	5.99	5.51	5.33	5.53	5.61
August	5.63	5.60	5.57	5.49	5.41	5.36	5.99	5.57	5.40	5.50	5.46
Mortgage Rate											
October	5.61	6.13	5.90	5.96	6.08	6.06	5.82	5.90	6.18	6.58	6.75
August	5.61	6.13	5.99	6.21	6.49	6.64	5.82	5.99	6.78	6.99	6.95
3 Month T-Bill Rate											
October	0.92	1.07	1.49	1.88	2.21	2.51	1.01	1.34	2.59	3.18	3.26
August	0.92	1.07	1.52	1.76	2.03	2.46	1.01	1.32	2.65	3.25	3.24

Table 3

Washington Forecast Comparison

	2004Q1	2004Q2	2004Q3	2004Q4	2005Q1	2005Q2	2003	2004	2005	2006	2007
Real Personal Income (Billions of Chained 2000 Dollars)											
October	194.200	196.763	198.295	201.543	201.762	203.724	193.306	197.700	204.881	213.207	222.011
Percent Change	1.2	5.4	3.2	6.7	0.4	3.9	0.9	2.3	3.6	4.1	4.1
August	194.444	197.210	199.261	203.165	203.403	205.407	193.707	198.520	206.627	215.287	224.640
Percent Change	0.4	5.8	4.2	8.1	0.5	4.0	1.3	2.5	4.1	4.2	4.3
Personal Income											
October	207.514	211.871	214.162	218.669	219.814	222.832	203.956	213.054	224.500	237.482	252.101
Percent Change	4.5	8.7	4.4	8.7	2.1	5.6	2.8	4.5	5.4	5.8	6.2
August	207.775	212.434	215.799	221.022	222.037	224.983	204.379	214.257	226.785	240.358	255.990
Percent Change	3.7	9.3	6.5	10.0	1.9	5.4	3.2	4.8	5.8	6.0	6.5
Wage and Salary Employment											
October	2675.5	2699.6	2714.1	2724.7	2738.5	2752.0	2658.0	2703.5	2756.8	2801.9	2848.8
Percent Change	1.3	3.7	2.2	1.6	2.0	2.0	0.2	1.7	2.0	1.6	1.7
August	2677.3	2699.5	2718.3	2733.2	2746.6	2761.1	2658.2	2707.1	2768.2	2821.8	2874.7
Percent Change	1.4	3.4	2.8	2.2	2.0	2.1	0.2	1.8	2.3	1.9	1.9
Manufacturing Employment											
October	261.0	262.0	262.0	264.2	265.8	267.5	266.7	262.3	267.8	275.1	281.9
Percent Change	-2.0	1.6	-0.1	3.4	2.4	2.5	-6.4	-1.6	2.1	2.7	2.5
August	261.1	262.3	264.2	266.8	268.3	269.2	266.7	263.6	269.8	276.7	283.7
Percent Change	-1.9	1.8	2.9	4.1	2.3	1.2	-6.4	-1.1	2.3	2.6	2.5
Construction Employment											
October	161.6	163.7	164.0	165.2	166.8	167.8	156.1	163.6	167.9	170.4	173.6
Percent Change	9.2	5.4	0.7	3.1	4.0	2.3	1.2	4.8	2.6	1.5	1.9
August	161.7	165.2	166.3	168.0	169.4	170.2	156.1	165.3	170.6	173.8	177.8
Percent Change	9.4	9.1	2.7	4.0	3.5	2.0	1.3	5.9	3.2	1.9	2.3
Housing Permits											
October	42.007	46.456	50.653	46.491	46.192	45.633	42.825	46.402	45.298	42.699	42.841
Percent Change	9.9	49.6	41.3	-29.0	-2.5	-4.8	6.5	8.4	-2.4	-5.7	0.3
August	42.007	46.456	45.592	45.240	45.420	44.780	42.825	44.824	44.703	43.869	43.834
Percent Change	9.9	49.6	-7.2	-3.0	1.6	-5.5	6.5	4.7	-0.3	-1.9	-0.1

Advisor's Name: _____

Forecast Worksheet
November 1, 2004

	2004:Q4	2005	2006	Average 2007:1,2
<u>U.S.</u>				
Real GDP, %Ch				
Baseline	3.4	3.4	2.9	3.3
Your Opinion	_____	_____	_____	_____
Implicit Price Deflator, % Ch				
Baseline	1.8	1.7	1.7	2.0
Your Opinion	_____	_____	_____	_____
Mortgage Rate, Percent				
Baseline	6.0	6.2	6.6	6.7
Your Opinion	_____	_____	_____	_____

Washington State

Real Personal Income, % Ch				
Baseline	6.7	3.6	4.1	3.9
Your Opinion	_____	_____	_____	_____
Wage and Salary Employment, % Ch				
Baseline	1.6	2.0	1.6	1.7
Your Opinion	_____	_____	_____	_____
Manufacturing Employment, % Ch				
Baseline	3.4	2.1	2.7	2.2
Your Opinion	_____	_____	_____	_____
Construction Employment, % Ch				
Baseline	3.1	2.6	1.5	2.0
Your Opinion	_____	_____	_____	_____
Housing Permits (Thousands)				
Baseline	46.5	45.3	42.7	42.6
Your Opinion	_____	_____	_____	_____
Washington Average Annual Wage, % Ch				
Baseline	1.6	3.8	4.3	4.5
Your Opinion	_____	_____	_____	_____